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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

NO. 76-331

The North Carolina Utilities Commission, Southeastern Association of Regulatory Utility Commissioners, et al.,

Petitioners,

v.

The Federal Communications Commission and the United States of America, et al.,

Respondents.

PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners, The North Carolina Utilities Commission ("NCUC") and the Southeastern Association of Regulatory Utility Commissioners ("SEARUC"), request this Court to issue a writ of certiorari to review the judgment of the Court of Appeals for the Fourth Circuit in this case.

Opinions Below

The decision of the Court of Appeals is reported at ——F. 2d——, and appears at Appendix A of the companion volume of appendices.[1] The decision of the

1. Citations herein to the appendices are to pages of Petitioners' Appendix — "Pet. App."

Federal Communications Commission ("FCC") is reported at 45 F.C.C. 2d 204, and appears at Appendix B.

Jurisdiction

The judgment of the Court of Appeals, which appears at Appendix C, was entered on April 14, 1976. Timely petitions for rehearing and rehearing *en banc* were denied on June 8, 1976 (Appendix D). This Court has jurisdiction under 28 U.S.C. §1254(1).

Question Presented

The question presented is whether the FCC exceeded its authority under Sections 2(b) and 221(b) of the Communications Act of 1934 when it preempted the jurisdiction of the state regulatory commissions over terminal equipment which is an integral part of the local telephone network and used predominantly in local and intrastate communications service.

Statutes Involved

Sections 2(b)(1) and 221(b) of the Communications Act provide as follows:

Section 2, 47 U.S.C. § 152, provides:

* * * *

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, ...

Section 221, 47 U.S.C. § 221, provides in part:

* * * *

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local government authority.

Other pertinent provisions of that Act and representative provisions of that Act and representative provisions of state regulatory statutes are set forth in Appendix E.

Statement of the Case

NCUC is the commission created by North Carolina and charged by North Carolina law with the responsibility, *inter alia*, for assuring the establishment and maintenance of telephone communications service within the state and assuring that such service is provided at just and reasonable rates. (N.C. Gen. Stats., Ch. 62, §§3(23)(a) (6), 30, 32 (1965). SEARUC is an organization consisting of the regulatory commissioners of the states of Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia. These commissions are charged by the laws of their respective states with responsibilities similar to those of NCUC.

This case presents the most fundamental and important question with respect to the proper spheres of jurisdiction of the FCC and the state commissions that has been presented to this Court since the FCC was created by the Communications Act of 1934.

This case involves the validity of an Order of the FCC, dated February 5, 1974, in its Docket No. 19808, in which the FCC declared that it had preempted state regulation of the connection of customer-provided terminal equipment to local telephone exchanges and intrastate switched telephone networks. (Order paras. 27, 38; Pet. App. [21b; 31b]) It thus presents the most fundamental important question with respect to the proper spheres of jurisdiction of the FCC and the state commissions that has been presented to this Court since the FCC was created by the Communications Act of 1934.

A. *Nature of the Telephone Services and Facilities Involved*

When a customer subscribes to telephone service, the local telephone company provides the subscriber with "station apparatus" or "terminal equipment" by means of which the subscriber makes and receives calls or otherwise obtains access to the telephone network. The terminal equipment is usually located on the subscriber's premises, and consists typically of the standard handset (i.e., the "telephone") that is used by virtually all residential telephone subscribers. The telephone company also connects the subscriber's terminal equipment to a pair of wires (a "subscriber loop") that lead to a central switching office — a local building that houses the telephone company's

switching apparatus. This arrangement gives a subscriber the capacity to make local exchange calls, intrastate long distance toll calls, and also, through ties to interstate lines or microwave transmission facilities, to make interstate long distance toll calls.

No matter what the ultimate destination of a subscriber's call, his message originates in the same terminal device and travels initially over the same wires to the same central switching office. If the message is intended for another telephone subscriber within the sender's local exchange area, it is switched directly onto circuits that lead from the central switching office to terminal equipment on the receiver's premises, or is directed to another nearby central switching office and from there routed to the receiver's premises. In either case, the sender has used "telephone exchange service," for which he pays the local telephone company a monthly exchange service charge regulated by a state regulatory commission.

If the telephone subscriber desires to send a message outside his exchange area but to a location within the state, the message originates with the same terminal equipment and travels over the same circuits into the same switching office. At this point, the message is routed to a toll switching center and from there transmitted to the exchange area of the intended receiver where the message is, in turn, switched to the receiver's premises. For this intrastate call between exchange areas, the subscriber must pay a separate long distance toll charge, regulated by a state regulatory commission.

Finally, a subscriber may wish to transmit a mes-

sage outside his telephone exchange area and into another state, for which he must also pay a separate toll charge. Again, the message will be sent initially over the same terminal equipment and circuits to the same switching office. The interstate call is routed to a toll switching center and then is transmitted by means of wires, cable or radio signals outside the sender's state to a toll switching center in the receiver's state. From there the message is routed to the receiver's exchange area and switched to the receiver's premises in the same manner as intrastate toll and local exchange calls.[2]

All calls over the switched telephone network make use of common terminal equipment, common lines to a central switching office, and common switching apparatus in that office. Of all calls transmitted over these common facilities, currently about 97% are local exchange or intrastate toll, and only 3% are interstate long-distance. (Order, par. 15; Pet. App. [14b])

Although the typical terminal equipment used by a subscriber is the standard telephone handset, other more sophisticated and specialized terminal equipment can sometimes be connected directly to the subscriber's "loop." This equipment includes, for example, private branch exchange switchboards (PBX's) for

2. A single telephone company does not necessarily have the physical facilities to provide all three types of switched telephone service. Hundreds of different telephone companies provide local exchange service, and since most of these companies do not own interstate facilities, their subscribers make long distance interstate calls through the physical connections of their local company with the long lines division of American Telephone and Telegraph Company (AT&T).

use in business communications systems, automatic answering and recording machines, and devices that provide for the transmission of computerized data through the telephone network. Telephone companies offer such equipment to their subscribers at additional charges. In addition, some unregulated manufacturers of terminal equipment offer to lease or sell their devices directly to subscribers for connection to the telephone company's network or attachment to the telephone company's terminal equipment where such connection or attachment has been permitted by tariffs filed with the state regulatory authorities.

B. *State Regulation of Local and Intrastate Charges, Classifications, Practices, Services and Facilities*

From virtually the beginning of the telecommunications industry in this country to the present, the North Carolina Utilities Commission and the other state commissions have regulated the charges, classifications, practices, services and facilities used in connection with local exchange and intrastate toll telephone service, including the terms and conditions on which a subscriber could replace the telephone Company's equipment with his own equipment or attach additional devices to the terminal equipment provided by the telephone company. This state commission regulation has been conducted pursuant to state regulatory enactments creating the commissions, granting them pervasive powers to regulate the carriers, and requiring the carriers to file tariffs describing the service and the rates therefor with the state commissions. The commissions have the power to review the tariffs to require modifications of rates, regulations or provisions governing facilities, and to compel adherence

to the tariffs as modified and approved.[3] For many years prior to 1934, as well as subsequent thereto, intrastate and local exchange tariffs filed by the local telephone companies with the state commissions have included provisions with regard to attachments and direct inter-connection of customer-provided terminal equipment to the telephone companies' networks.[4]

From its inception, state regulation of telephone service has been premised upon the decisions of state legislatures that the public interest is *not* served through unrestricted competition in the provision of telecommunications service. Prior to regulation (and after expiration of the initial telephone patents), anyone could set up a telephone exchange and offer telephone service. The result in many towns was two or three competing telephone exchange systems, requiring subscribers to install and pay for two or more telephones side-by-side in order to be able to reach every other subscriber. Such duplicative facilities required far more investment than was necessary to create an efficient telephone network.[5]

3. Representative state statutory provisions are set forth in Appendix E.

4. For example, the General Exchange Tariff for Southern Bell filed with the North Carolina Commission in 1920 and in effect in 1934 provided that "no instrument, appliance, or device of any kind, not furnished by the telephone company shall be attached to or in any way used in connection with such telephone equipment, apparatus and lines [furnished by the telephone Company]." Similar provisions appeared in the intrastate and exchange tariffs of Southern Bell and other telephone companies on file with the other state commissions in 1934. By contrast, AT&T's tariffs covering long-distance service do not offer telephones or other terminal equipment.

As unregulated entities, the early telephone companies were also free to serve whatever locations they chose, and thus they frequently elected to serve only the most profitable segments of the geographical markets in which their lines were located. Those segments consisted of areas whose residents were wealthy and could afford to pay high rates for telephone service, and areas that were the least costly to serve, such as densely populated central business districts. This pattern of unregulated competition placed outlying and rural areas, as well as poor urban residential areas, at a critical disadvantage in receiving telephone service.

The response of the state legislatures to these problems was to substitute regulation for competition as the means of promoting the public's interest in widely available telecommunications service at reason-

5. The Supreme Court of Pennsylvania accurately described the deleterious effects of this early structure of the telecommunications industry in *Perry County Tel. & Tel. Co. v. Public Service Commission*, 108 A. 659, 660-661 (1919):

> "[D]uplication of facilities merely results in the placing of an additional burden upon the public by forcing patrons to maintain two systems where one would serve the purpose as effectually and at less cost. . . . The duplication of telephone systems in a given locality without connection between their lines requires subscribers to install both systems and pay for double service to reach subscribers on but one of the two systems; or, as frequently happens, subscribers maintain both systems when they can reach other users with equal facility on either system."

able prices.[6] Typically, state regulation was and continues to be premised on the principle that a telephone company is a common carrier public utility, and as such it is required to serve all segments of the public and to do so on fair and non-discriminatory terms. The state regulatory agencies were given power fully to regulate the price of telephone service to different groups of subscribers and to require that such service be made available to all without regard to costs of such service for particular groups of subscribers. To be sure, the state regulatory agencies are obliged by constitutional and statutory standards to permit regulated telephone companies to earn revenues sufficient for a fair overall return. But so long as such a fair overall return can be earned, it is the responsibility of the regulatory agencies, not the telephone companies, to determine the amounts different classes of telephone users should contribute to meet the companies' overall revenue requirements.

As a corollary to regulation in the public interest, state regulatory agencies were also given the power to limit entry into the telecommunications industry. Since the public interest frequently required the maintenance of rates unrelated to costs, this control over entry was absolutely critical to the regulatory scheme. Otherwise, unregulated competitors could enter those portions of the market in which rates were relatively high in comparison with costs and "skim the cream" of the business — a practice that would be plainly

6. State regulation of telecommunications became widespread beginning in the late 1890's and by 1910 only a few states had not enacted regulatory statutes. Today every state has an agency charged with the responsibility of regulating telecommunications within its borders.

detrimental not only to the regulated telephone company, but also ultimately to the ordinary residential user for whose benefit these relatively higher rates were prescribed in order to make possible the availability of basic telephone service at reasonable rates within his reach.

Effective state regulation of rates and rate structures is dependent upon the power of state regulatory agencies to regulate entry into the market for telephone facilities and interconnection devices. This dependence was explained in testimony before a Senate Committee investigating broad aspects of the telecommunications industry by Professor Cyrus J. Colter, for more than 23 years a member of the Illinois Commerce Commission (*Hearings on S. 1167 Before the Subcom. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 93d Cong., 2d Sess., pt. 5, at 3812-3913 (1974)):

> "At present, the state regulator is able to design rates in a way that the charge for the basic services — i.e., for the use of his telephone by the average householder — is held low, while other charges, such as for terminal facilities, extensions, PBX's, etc., are kept higher. Also, residential rates are invariably kept lower than business rates. These rate policies are not new, but historical, and have served the nation well.
>
> "But now these new — and I can only call them selfish — interests have appeared with the clear intention of under-pricing in those special areas in which regulators have heretofore kept the prices higher; kept them higher in order to provide lower, though reasonable, charges for the great body of

household telephone users across the country. Such competition may be good for these special interest entities which are not at all averse to competing with a regulated system. But it is not good, in my opinion, for the American public, especially the part of it which is economically disadvantaged — the unfortunate. It ties the regulator's hands as he attempts to set rates which will meet overall public interest standards — and especially the needs of the poor, the elderly, and the ill.

"To allow selective entry into this market by, for example, the specialized common carrier can only result in a further dislocation of present tenuous regulatory rate options. Regulators would then have no choice but to give greater weight than formerly to the cost of serving each class of customer with the result that a steeper rate of increase to the lower-income telephone user would be inescapable. Some may ask, 'What's wrong with that? This customer is only being asked to pay his fair share — what it costs to serve him.' What, in my opinion, is wrong with it is that it lacks the input of responsible government with a social conscience — without which a government will not long be governing."

The powers to regulate rates and entry thus conferred upon state regulatory agencies became a powerful tool for the development and implementation of public policy. Most regulatory agencies early recognized that business subscribers receive greater value than residential subscribers from telephone service. On the basis of the value of service principle, business subscribers have generally been required to pay higher

rates than residential customers, thus permitting the regulatory agencies to keep residential rates relatively lower and thereby to promote the general availability of service. See, *e.g.*, *Pacific Telephone & Telegraph Co.*, P.U.R. 1919D 345, 370-371 (Ore. P.S.C. 1919). A similar policy objective has been pursued by virtually all of the states insofar as rural subscribers were concerned. Although it has been recognized that rural and lightly populated areas are much more costly to serve, regulatory agencies have required statewide uniformity of rates for important aspects of telephone service, thus causing many urban subscribers to pay rates in excess of the costs of their service in order that rural subscribers can obtain service at rates they can afford. See, *e.g.*, *Pacific Telephone & Telegraph Co.*, P.U.R. 1922C 248, 272 (Ore. P.S.C. 1922); *Mountain States Telephone & Telegraph Co.*, P.U.R. 1918F 415, 664 (Colo. P.S.C. 1918). Yet another frequently used ratemaking practice has been that of requiring relatively high charges for certain terminal equipment in order to hold down other rates and charges. Thus, extension telephones have generally been priced at levels well above their costs on the theory that those using such telephones (presumably wealthier subscribers) should make a relatively larger contribution than subscribers using only main station service. See, *e.g.*, *Morris v. New Jersey Bell Telephone Co.*, 6 P.U.R. (n. s.) 258, 260-261 (N.J.B. P.U.C. (1934)). The same principle has often been applied to so-called decorator phones — that is, telephones designed to complement the decor of the rooms in which they are placed. See, *e.g.*, *General Telephone Co. of Cal.*, 80 P.U.R. 3d 2, 74-76 (Cal. P.U.C. 1969); *Chesapeake & Potomac Telephone Co. of Maryland*, 56 P.U.R. 3d 91, 115 (Md. P.S.C. 1964). And many states have recognized the

greater value of service to business of sophisticated terminal equipment such as private branch exchanges (PBX's) and key telephone systems by establishing rates for such equipment substantially in excess of costs, thereby again lessening the burden upon basic residential subscribers. See, *e.g.*, *General Services Administration v. New York Telephone Co.*, 63 P.U.R. 3d 451, 462-63 (N.Y. P.S.C. 1965); *Public Service Commission v. Mountain States Telephone & Telegraph Co.*, P.U.R. 1927B 193 (Mont. P.S.C. 1926).

The overriding principle that explains all these ratemaking practices is the promotion of universal telephone service. Having struggled through a period of competition in the telecommunications industry that sharply restricted both the availability and the usefulness of telecommunications services, the states developed ratemaking policies designed to cure the basic defects that plagued the early days of the industry. This principle has been articulated by numerous regulatory agencies. In *Pacific Telephone & Telegraph Co.*, P.U.R. 1919D 345 (Ore. P.S.C. 1919), for example, the Oregon Public Service Commission held (*id.* at 370-371):

> "Residence service costs more for investment and but little less for operation than business, yet the rates must be much lower or service will not be taken. It is the extensive use of telephones in residence service that makes their use valuable to business. . . . [R]esidence service is commonly conducted at a loss made up in the charges for business use. . . . . Any attempt to make rates proportionate to cost would result in residence charges so high that few householders would use the telephone at all. . . ."

See also *Southern Bell Telephone & Telegraph Co.*, P.U.R. 1929E 392, 396-397 (La. P.S.C. 1929); *Board of Trade v. Mountain State Telephone Co.*, P.U.R. 1916C 688, 700-701 (N.Y. P.S.C. 1916); *Empire Telephone Co.*, P.U.R. 1915B 561, 565 (Ill. P.U.C. 1915).

This is not to say, of course, that all states have followed identical policies in structuring rate schedules; complete uniformity in regulation among the states does not now exist, nor has it ever existed.[7] Quite obviously, the need for a relatively greater contribution from business, urban and special equipment users to support reasonable residential rates for basic service will vary from state to state, depending upon the level and distribution of personal income throughout the state, the nature and extent of business activity, the pattern of population dispersion and numerous other factors. However, it remains true that in most if not all of the states, reliance upon ratemaking powers is necessary to promote the broad availability of telecommunications services to the widest possible range of users so as to override particular cost considerations that exist in various areas of the state and among various classes of users. Hence, most states, including

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7. At least one state regulatory agency has determined, for example, that the public interest within its state is best served by a limited amount of competition in the provision of telephone terminal equipment and has liberalized somewhat the conditions upon which certain customer-provided terminal equipment can be connected directly to the network. See, *Investigation . . . into the Promulgation of a General Order Providing for . . . the Interconnection of a Customer-Opinion and Order*, Case No. 9625 Cal. P.U.C. (April 22, 1975). California's policy was necessarily based upon the state regulatory agency's assessment of the particular conditions existing in that state.

the states represented here, still require the maintenance of non-cost related rate structures in order to hold down the price of basic residential service and thereby to bring such service within the economic reach of a maximum number of households. See, *e.g.*, *Southwestern Bell Telephone Co.*, 95 P.U.R. (n.s.) 1, 9 (Ark. P.S.C. 1952); *Mutual Telephone Co.*, 76 P.U.R. (n.s.) 389, 402-03 (Hawaii P.U.C. 1948); *Southern Bell Telephone & Telegraph Co.*, 18 P.UR. 3d 113, 124 (Ky. P.S.C. 1957).

Prior to the instant Order, the FCC had never sought to deprive the states of their traditional jurisdiction over terminal equipment or rates and rate structures applicable to various forms of local exchange service, or entry into any facet of the market for local service. In the few instances where the FCC had asserted exclusive jurisdiction over terminal equipment used in common for both intrastate and interstate communications, the equipment was not used in connection with switched telephone exchange service within the meaning of the Communications Act.[8] The then Chairman of the FCC recently reaffirmed this position in a letter, dated July 9, 1973, to Senator Jennings

8. See, *American Telephone & Telegraph Co.-TWX*, 38 F.C.C. 1127 (1965); *Department of Defense (DOD) v. General Telephone Co.*, 38 F.C.C. 2d 803 (Review Board 1972), *aff'd* 41 F.C.C. 2d 1047 (1973), *aff'd per curiam St. Joseph Telephone & Telegraph Co. v. F.C.C.*, 505 F.2d 476 (D.C. Cir 1974); *General Telephone Co.*, 13 F.C.C. 2d 448 (1968), *pet'n for reconsideration denied*, 14 F.C.C. 2d 695 (1968). In the *General Telephone Co.* case, for example, the Commission stressed that its assertion of jurisdiction over cable TV facilities did not threaten states' jurisdiction over terminal facilities used for intrastate and local exchange telephone service (14 F.C.C. 2d, at 696).

Randolph, Chairman of the Senate Subcommittee on the Handicapped, who had inquired whether the FCC required the hearing aid industry to provide equipment for the coupling of hearing aids to telephone instruments. Chairman Burch replied that the FCC lacked jurisdiction over facilities used in local exchange service:

> "We . . . lack primary jurisdiction over telephone sets which are a primary part of the facilities used in providing exchange telephone service. As you know, the Communications Act specifically excludes the Federal Communications Commission from any authority with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate and exchange telephone services of any telephone company; such local service matters are subject to the regulatory authority of State commissions in the various States."
>
> 119 Cong. Rec. S17297 (daily ed., Sept. 22, 1973).

Where the FCC has in the past exercised its jurisdiction over interstate aspects of the switched telephone network, it has been careful not to infringe upon state regulation of intrastate and exchange tariff provisions. In each case in which the FCC considered the lawfulness of tariff provisions governing interconnection, the Commission ruled only on the legality of interconnect conditions that were part of the *interstate* tariffs of telephone companies. See, *Use of Recording Devices*, 11 F.C.C. 1033 (1947); *Jordaphone Corp. v. American Telephone & Telegraph Co.*, 18 F.C.C. 644, 671 (1954); *Hush-A-Phone Corp. v. American Telephone & Telegraph Co.*, 22 F.C.C. 112, 114 (1957); *Carterfone*, 13 F.C.C. 2d 420, 426-27 (1968).

In *Jordaphone*, for example, the Commission respected the states' jurisdiction when it invalidated a provision in carriers' interstate tariffs that prevented the use of automatic answering and recording devices in connection with interstate communications. The Commission noted that "[t]he device, primarily used in connection with intrastate and local telephone service, would only *incidentally* be used to answer interstate and foreign calls" (18 F.C.C. 644, 670). The Commission then concluded (*id.* at 671):

> ". . . the foreign attachment provisions in the present interstate and foreign toll telephone message tariffs of the defendant telephone companies are unjust, unreasonable, and therefore, unlawful *to the extent that* they may be interpreted to prohibit the installation and use by the subscriber, of a telephone answering device not furnished by the telephone company *in any community or state in which the use of such answering device with respect to intrastate or exchange telephone service is authorized by appropriate local or state regulatory agencies or commissions.*" (Emphasis supplied)

The effect of this holding was to make the lawfulness of interconnection provisions in interstate tariffs depend upon whether the states allowed attachment of the recording devices to their telephone systems. Where states allowed such interconnection, prohibitions in the interstate tariffs were invalid; where states prohibited interconnection, like prohibitions in interstate tariffs remained valid.

In *Hush-A-Phone, supra*, and *Carterfone, supra*, the FCC similarly acted with respect to the interstate

tariffs of telephone companies. No question of allowing customers to substitute their own equipment for company-provided equipment was involved in either of those cases. In both cases the Commission held unlawful provisions in interstate tariffs that prohibited the connection of the foreign attachments in question to the telephone network. *Hush-A-Phone*, 22 F.C.C. at 114; *Carterfone*, 13 F.C.C. 2d at 426-27. The Commission ruled in each case that a subscriber's attachment of the additional devices to his telephone set did not cause harm to the telephone companies' facilities and employees and did not interfere with the public's use of the telephone system. The Commission therefore ordered in *Hush-A-Phone* that the telephone companies file revised interstate tariff schedules rescinding and cancelling any tariff regulations that prohibited the use of the *Hush-A-Phone* "in connection with interstate or foreign telephone service," 22 F.C.C. at 114; and ordered in *Carterfone* that the prohibitions on interconnection in the interstate tariffs then on file with the FCC be stricken as unlawful. 13 F.C.C. 2d at 426-27. In neither case, however, did the FCC purport to rule on the legality of provisions in any *intrastate* tariff that might prohibit the connection of such devices to the telephone network.

C. *Proceeding in North Carolina Leading to the FCC's Preemption Order*

Following the FCC's decision in *Carterfone*, the telephone companies in interstate communications filed with the FCC amended tariffs that changed previous restrictions on the connection of customer-provided terminal equipment to provide that interconnection would henceforth be permitted, subject generally

to two requirements designed to safeguard the telephone network: (1) that any network control signaling unit must be furnished, installed and maintained by the telephone company; and (2) that no subscriber could connect terminal equipment directly to the telephone network without the use of a protective interface device supplied by the telephone company. In addition to filing these revised interstate tariffs with the FCC, the telephone companies filed similar revised tariffs with the regulatory commissions of the states in which the companies provided intrastate and local exchange service, including North Carolina and other states.

The North Carolina Utilities Commission thereafter instituted an investigation into the effects of interconnection on several broad areas of public interest, including the quality, pricing, and availability of telephone service in North Carolina.[9] By Order of Investigation dated February 2, 1973, the North Carolina Commission announced that the purpose of the investigation was "to determine if as a general policy the public interest will be served by permitting the substitution of subscriber-provided equipment for that traditionally provided by the telephone companies." (North Carolina Order, February 2, 1973, p. 12.) The North Carolina Commission noted an increasing use of customer-provided terminal equipment following the FCC's *Carterfone* decision and the telephone companies' subsequent tariff revisions (*id.* at 4), and stated that

9. *In Re Investigation of Interconnection of Subscriber-Provided Equipment with the Telephone Network of Telephone Companies Under the Jurisdiction of the North Carolina Utilities Commission*, Docket No. P-100, Sub. 31.

its investigation would be "structured to investigate the economic and service impact that interconnection is or will have in North Carolina and what change, if any, should be made in the method of providing telephone service and establishing telephone rates." (*Id.* at 12.)

The North Carolina Commission noted that the National Academy of Sciences (NAS) had studied the feasibility of maintaining service quality while allowing interconnection of customer-provided equipment,[10] and that the Academy's report included a finding that uncontrolled interconnection to the common carrier network as it now exists would be harmful. (*Id.* at 2-3)[11] The North Carolina Commission also expressed concern that the proliferation of terminal equipment supplied by unregulated manufacturers would have a major

10. "Report of a Technical Analysis of Common Carrier/User Interconnections" by the Special Panel on Common Carrier Interconnection of the National Academy of Sciences' Computer Science and Engineering Board. The study was undertaken pursuant to a contract with the FCC and was released by the FCC in connection with Public Notice 51094, July 1, 1970. See 35 F.C.C. 2d 539, 540 (1972).

11. The NAS report had advised, in particular, that the telephone network must be protected from harm to service and equipment in four broad areas: hazardous voltages and currents, excessive signal power, improper network control signaling, and improperly balanced terminal equipment. These malfunctions can cause physical harm to telephone company personnel; damage to sensitive equipment throughout the system; noise and interference in other subscribers' communications (including "cross-talk," where one subscriber's message is overheard on the line of another); wrong numbers; dial tone delays; interrupted connections; incorrect billings; and over-use of telephone company operators, repairmen, and other personnel to remedy these problems.

impact upon the rate structures for local residential service. (North Carolina Order, February 2, 1973, p.p. 10-11.) The largest market for such terminal equipment is in sales of sophisticated and expensive terminal equipment used predominantly by business subscribers. If unregulated manufacturers were permitted to "cream skim" in this segment of the market the telephone companies would be obliged to lower their prices on comparable equipment or lose the business to the manufacturers' lower priced direct sales. Whether the business user buys terminal equipment from an unregulated supplier or from the telephone company at reduced rates, the telephone companies would lose revenues which would have to be recovered elsewhere in the rate structure, most notably in the charges for basic telephone service.[12] The North Carolina Commission thus concluded that "the advantages of interconnection rest with the business subscriber, not with the residential subscriber." (*Id.* at 4.)

Following the submission of studies and data relating to the issues by most of the telephone companies in North Carolina, the North Carolina Commission issued a further Order on June 29, 1973, giving notice of proposed rulemaking, and stating (pp. 2-3):

> ". . . [T]he Commission is of the opinion that the interconnection of subscriber-provided equipment

12. A recent study conducted by the National Association of Regulatory Utility Commissioners concluded that widespread connection of customer-provided terminal equipment could result in increased telephone rates for local residential and other users approximately $360-740 million annually by 1980, and approximately $1 billion annually by 1984. *NARUC Report after Investigation*, May, 1974.

> affects the public interest, and that a public hearing should be held in connection with the investigation herein to determine reasonable rules for the protection of the public interest in economical and reliable telephone service as it might be affected by the interconnection of subscriber-provided equipment . . . and to determine what rules are required to guarantee to the general body of subscribers that the quality of service and economy of service of the basic telephone network is not adversely affected by further and continued use of customer-provided equipment."

The North Carolina Commission set forth in its Order a proposed Rule R9-5 which gave notice of the maximum scope of the investigation, and under which no telephone company doing business in North Carolina would be permitted to provide service over its communications system "except through station apparatus and equipment installed, owned and serviced by the telephone company and for which the telephone company takes complete responsibility to its customer" [Rule R9-5(a)]. The Rule would further provide that the telephone company "shall own, service and be fully responsible for and accountable to the Utilities Commission and to its customer for adequate service and maintenance of all equipment used in telephone service in North Carolina." (*Id.*)[13]

13. Other states similarly indicated an intention to enforce regulations or limits on interconnection of customer-provided termial equipment. The Attorney General of Nebraska ruled that a hotel which used its own telephone equipment was itself required to obtain a state certificate of public convenience and necessity. (Pet. App. [2b; 37-38b] And the Oklahoma commission affirmed its requirement that in cer-

On August 8, 1973, following the announcement by the North Carolina Commission of its proposed Rule R9-5, Telerent Leasing Corp., a North Carolina supplier of equipment for interconnection, the North American Telephone Association (NATA), and other equipment suppliers in North Carolina and Nebraska, filed with the FCC a Petition for Order and Declaratory Ruling, requesting the Commission to rule that its regulation of interstate interconnection had preempted state regulation of interconnection with local exchange and intrastate telephone systems. NATA is a national trade organization of unregulated companies engaged in the manufacture, distribution, installation and maintenance of interconnecting terminal equipment of the type that is the subject of the proposed North Carolina Rule. NATA contended in the Petition that the action of the North Carolina Utilities Commission had caused a decline in the markets for the terminal equipment sold by its member firms with resulting lost profits to NATA members. (NATA Petition, pp. 30, 33; Order, par. 10).

Responding to the NATA Petition, the FCC stated (43 F.C.C. 2d 487):

> "The primary question raised by the petition is whether and, if so, to what extent the actions which we have taken on interconnection of customer-provided communications equipment to the nationwide switched public telephone network have preempted state action in this area."

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tain circumstances interconnection of customer-provided equipment would require a certificate of public convenience and necessity. (Pet. App. [39b])

Oral argument before the Commission *en banc* was held on October 30, 1973, and the Commission adopted its Memorandum Opinion and Order on January 31, 1974 (released February 5, 1974), granting the declaratory relief sought (45 F.C.C. 2d 204; Pet. App. [40b]).

> "57. In the light of all of the foregoing, IT IS HEREBY ORDERED that the petition for a declaratory ruling IS GRANTED to the extent reflected and IS OTHERWISE DENIED."

In its Order, the Commission declared that its regulation of the technical standards for interconnecting terminal equipment used for interstate communications had preempted the states' authority to control the interconnection of customer-provided terminal equipment in intrastate and local exchange telephone systems. The Commission ruled that it had "primacy in authority over the terms and conditions governing the interconnection of customer-provided equipment to the nationwide telephone network," (Pet. App. [31b]), notwithstanding the fact that 97% of the messages transmitted over the average subscriber's terminal equipment are entirely intrastate or local exchange communications. The Commission thus decreed, over the strenuous objections of many state commissions, that "where the rendition of interstate and foreign service is dependent upon plant facilities which are also used for exchange or other interstate services, the Federal role must be controlling." (Pet. App. [21b]). The Commission accordingly declared that the proposed Rule of the North Carolina Utilities Commission was in direct conflict with the interconnect policy of the FCC, and if

adopted and enforced, would be invalid as contrary to preemptive and superseding federal regulation. (Pet. App. [20b].[14]

Following its preemption order involved in this case, the FCC in its separate Docket No. 19528 exercised its newly-claimed jurisdiction by promulgating a series of orders establishing a massive new federal regulatory program permitting direct interconnection of customer-provided terminal equipment to the local telephone company exchange facilities. Such interconnection was permitted upon registration of the equipment with the FCC. The states and the telephone companies were prohibited from requiring use of protective interface devices to safeguard the telephone network. The FCC's orders in that proceeding are presently on appeal to the United States Court of Appeals for the Fourth Circuit (Nos. 76-1002, 76-1152, 76-1292, 76-1415, 76-1416, 76-1443, 76-1467 and 76-1502). That case has been briefed, and argument is scheduled for September 21, 1976.

D. *The Decision of the Court of Appeals for the Fourth Circuit*

The Court of Appeals for the Fourth Circuit affirmed the FCC's preemption order by a 2-to-1 vote. The majority opinion adopted a construction of Section 2(b) of the Communications Act which would fragment

14. The Commission also declared that certain regulation by the authorities in Nebraska and Oklahoma of interconnection to intrastate and local exchange networks (see *supra*, p. 23, fn) would be invalid as contrary to the FCC's preemptive jurisdiction over interconnection. (Order, paras. 52, 55-56; Pet. App. [37-38b; 39-40b]).

jurisdiction over "charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communications service." The court construed Section 2(b) as authorizing the FCC to regulate "facilities" used in local and intrastate service, but not the "charges" applicable to such service. The majority held that the FCC had jurisdiction over interstate facilities — including the power "to determine what terminal equipment can safely and advantageously be interconnected with the interstate communications network and how this shall be done" (Pet. App. [12-13a]). Since the same facilities were used for both interstate and intrastate calls (though only approximately 3% for interstate calls), the federal and state regulatory rules for these same facilities might conflict. The court ruled that under Section 2(b) the federal rule — that of the FCC — preempted the rule of the states.

However, the court ruled that under Section 2(b), the states could continue to regulate local and intrastate telephone rates. (Pet. App. [13a, n.6]) The court did not attempt to reconcile its fragmented view of Section 2(b) with the fact that by its express terms Section 2(b) protected the jurisdiction of the state commissions over intrastate "facilities" in the very same phrase where it protected their jurisdiction over intrastate "charges". Instead, the court based its analysis upon the legislative history of Section 2(b), which showed that the states' concern about the possible expansion of power on the part of the new FCC "Focuse[d] upon the desire of state authorities to regulate local telephone rates and charges." (Pet. App. [13a, n. 6]) The majority reasoned that paramount federal jurisdiction over facilities would not interfere with

state jurisdiction over rates since "rate making typifies those activities of the telephone industry which lend themselves to practical separation of the local from the interstate. . . ." (*Id.*) Accordingly, the majority held that extending FCC jurisdiction to local facilities would not result in encroachment upon state ratemaking powers. On this basis, it held that its decision was consistent with the legislative history of the Communications Act, which, as even the FCC had conceded,[15] showed plainly that the states were intended to have exclusive jurisdiction over the "local telephone rates and charges," including the rates and charges for terminal equipment. (*id.*)

Petitions for rehearing were denied by a 1-to-1 vote.[16] (Pet. App. [1d]). Rehearing *en banc* was also

15. The FCC expressly recognized throughout its proceedings herein that the Communications Act preserved the exclusive jurisdiction of the states over local telephone exchange rates and charges. Thus, in its opinion and order the Commission conceded that only the states could regulate intrastate rates (45 F.C.C. 2d at 219):

> "[T]he legislative history of the Communications Act clearly shows that in enacting Sections 2(b) and 221(b), the Congress was primarily concerned with the preservation of traditional State jurisdiction of intrastate rates and services. . . ."

In its brief on appeal to the court below, the FCC again recognized that both the language of the Communications Act and its legislative history plainly shows a purpose "to avoid federal intrusion into purely intrastate matters — rates, in particular" (Brief for FCC at 31).

16. The panel consisted of Judge Widener, from the Fourth Circuit, and Judges Hastie and Tuttle, from the Third and Fifth Circuits. Judge Hastie died shortly after the opinion was filed.

denied because all other active judges in the Fourth Circuit were disqualified from sitting in the case. (Pet. App. [1d]).

Reasons for Granting the Writ of Certiorari

I.

The Court Below Erred in Holding That Section 2(b) of the 1934 Act Does Not Protect the Jurisdiction of the State Commissions Over Facilities Used For Local and Intrastate Communications Service.

In Section 2(a) of the Communications Act of 1934, Congress authorized the FCC to regulate "interstate and foreign communication." (47 U.S.C. §152(a)) This grant of jurisdiction was qualified, however, by Section 2(b) of the Act, which provided that the FCC may not use its jurisdiction over interstate communications to intrude upon the states' jurisdiction over intrastate communications, charges, services or facilities (47 U.S.C. §152(b)):

> "Subject to the provisions of section 301 of this title [dealing with radio frequencies], *nothing* in this chapter *shall be construed to apply or to give the Commission jurisdiction with respect to* (1) charges, classifications, practices, services, *facilities*, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, ..." (Emphasis supplied.)

In Section 221(b) of the Act Congress also expressly reserved to the states the right to regulate "telephone exchange service," even though communication within

the telephone exchange area may be across state lines (47 U.S.C. §221(b)):

> "Subject to the provisions of section 301 of this title, *nothing* in this chapter *shall be construed to apply, or to give the Commission jurisdiction, with respect to* charges, classifications, practices, services, *facilities*, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State Commission or by local governmental authority." (Emphasis supplied.)

The jurisdictional dispute between the FCC and the state commissions presented in this case arises out of the fact that the same local telephone facilities — including the basic telephone handset — that are used for both local and intrastate service are also connected by interstate trunk lines to provide interstate service.

There is nothing new about this question of who should be authorized to regulate the telephone handset and other terminal equipment. In 1934, just as today, the same local telephone exchanges and switching facilities, the same telephone handsets, and the same local loops connecting the telephone to the central exchanges, were all (or virtually all) used both for local or intrastate calls and for interstate calls. The question thus arose: which level of government, the federal government or the states, should provide the regulatory rule which would govern these instruments of both local and interstate communications service. Congress knew that at that time approximately 98% of all calls were local

or intrastate calls, and only approximately 2% were interstate. (78 Cong. Rec. 10316 (1934)) Thus, it decided that "the tail should not wag the dog," and that the state commissions should continue to regulate local facilities, services, and rates. To accomplish this purpose it provided in Section 2(b) that "*nothing* in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, *facilities*, or regulation for or in connection with intrastate communication service by wire or radio of any carrier, ..." (Emphasis supplied.)[17]

In this respect, nothing has changed since 1934. Local exchanges and intrastate telephone messages still amount to approximately 97% of total messages. And

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17. Section 221(b) deals with the situation where a local telephone exchange overlaps state boundary lines and includes two or more states, and provides that even in this situation— where what is essentially a local call happens also to be an interstate call — "nothing in this chapter shall be construed . . . to give the Commission jurisdiction with respect to charges, classifications, practices, services, facilities, or regulations . . . *in any case where such matters are subject to regulation by a State Commission or by local governmental authority.*" (Emphasis supplied.) This latter italicized language does not appear in Section 2(b), making it clear that in the case of ordinary local exchanges (which do not overlap state boundaries) the absence of FCC jurisdiction does not depend upon the existence of regulation by a state commission or local governmental authority. Thus, under Section 221(b) state regulation takes precedence over FCC regulation where a local exchange overlaps state boundaries; and nothing could make it plainer that the FCC has no jurisdiction at all over local exchanges or facilities where there is no such overlap or interstate communication.

Congress has not repealed Section 2(b) or amended Section 2(b) by omitting the word "facilities."

The court below erred in treating this case as a typical preemption case, involving conflicting federal and state enactments or regulations where under the "supremacy clause" the federal rule must take precedence over the state rule. Such analysis has no applicability in construing the pertinent sections of the Communications Act to determine whether Congress intended the FCC or the states to regulate the facilities used predominantly for local and intrastate service.

The court below reasoned that since the FCC had jurisdiction over interstate communications, and since local facilities are used (approximately 3% of the time) in making interstate communications, therefore the FCC's jurisdiction must override or preempt the jurisdiction of the state commissions insofar as those local facilities are concerned. This would, in the court's view, leave the state commissions with "regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." (Pet. App. [13a]). However, such a contruction of Section 2(b) ignores the fact — which was true in 1934 and is true today — that such "separable" facilities do not exist, and that virtually every local telephone in this country, and every local exchange, can be used to make an interstate call. Thus, the court below construed the prohibitory language of Section 2(b) so as to be totally without practical effect so far as the use of the word "facilities" is concerned. Such a construction is not only contrary to the plain language and obvious purpose of the Act, but it is

also contrary to the decisions of other courts construing the Act,[18] and is unsupported by any decision of this Court or any other court.

Indeed, such a construction is directly contrary to the FCC's own understanding of the statute, expressed in 1968 in *General Telephone Co.*, 14 F.C.C. 2d 695 (1968). There the FCC expressly acknowledged that Congress had been aware since 1934 that "every telephone can be connected with a trunk line for interstate calls." However, this "circumstance" of common instrumentalities used in both intrastate and interstate service has not led Congress to empower the FCC to regulate the common instrument. In fact, just the opposite was true. Congress had decided that since interstate use was "merely incidental," that common instruments should "remain under state regulations," and that "the tail should not wag the dog" (14 F.C.C. 2d 696):

> "When the Communications Act was enacted in 1934, Congress was concerned that the telephone might be considered an instrumentality of interstate communication merely because of the circumstance that every telephone can be connected with a

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18. In *Kitchen v. FCC*, 464 F. 2d 801 (D.C. Cir. 1972), the court held that a telephone building which was to house both local exchange and toll switching equipment was subject to state jurisdiction and *not* FCC jurisdiction even though the facility would be used in part for interstate communications. In *Southwestern Bell Telephone Co.* v. *United States*, 45 F. Supp. 403, 406-407 (W.D. Mo. 1942), the court held that the FCC had no jurisdiction over communications between the states of Kansas and Missouri within an area defined as a single local telephone exchange area. See also *General Telephone Co. of the Southwest* v. *Robinson*, 132 F. Supp. 39, 43 (E.D. Ark. 1955).

toll line for interstate calls. Since the interstate calls of the independent telephone companies were such a small part of their business as to be merely incidental, Congress agreed with the USITA position that *'the tail should not wag the dog'; that their telephone facilities should remain under State regulation, primarily because they were essentially local but also to avoid an unnecessary burden to the Commission and the small independent companies. . .*" (Emphasis supplied)

It is important that this basic jurisdictional issue be conclusively resolved by this Court. In the absence of such resolution, FCC efforts to preempt the state commissions over essentially local facilities and services will continue, leading to further controversy as to the limits of FCC jurisdiction and to further litigation.[19] As already pointed out (*supra*, p. 26), the FCC has promulgated a sweeping new program for "registration" with the FCC, of all terminal equipment connected to the local exchange networks, and the FCC's orders establishing this program are presently on appeal. Also, the FCC has relied on its *Telerent* decision in ruling that the states of California and Oklahoma

19. An example of the controversy raging in the wake of the FCC's preemption efforts is found in a statement of policy issued by the Iowa State Commerce Commission regarding the FCC Docket No. 19528 (the "registration" case). The Iowa Commission stated that, in its view, the Communications Act of 1934 protected the authority of the states over intrastate telephone service, including connection of terminal equipment. The Iowa Commission further stated that it felt bound neither by the FCC nor the Fourth Circuit decision which is the subject of this Petition. See Statement of Policy, Iowa State Commerce Commission, Docket No. RES 76-1, issued April 26, 1976.

must permit specialized carriers to provide particular intrastate telephone services, as well as the interstate services that the FCC has authorized the carriers to provide. *AT&T*, 56 F.C.C. 2d 14 (1975), *pet'n for review pending sub nom. California v. F.C.C.*, D.C. Cir. No. 75-2060 and consolidated cases.

II.

The Decision Below Nullifies Amendments to the Act Which Were Obtained by the States to Protect Their Jurisdiction Over Intrastate "Services" and "Facilities."

The state commissions would never have supported enactment of the Communications Act of 1934, and the legislative history of the Act shows it would never have been passed, if Section 2(b) and 221(b) had not been added to the Act for the express purpose of preserving the jurisdiction of the state commissions over local telephone charges, services, and facilities. As shown above (*supra*, p. 7, *et seq.*), for decades prior to 1934, the states had regulated local and intrastate service, the conditions of such service, the charges and rate structures applicable to such service, and the right to enter into the market for such service. The states and state commissions feared in 1934 that a newly-created FCC with jurisdiction over interstate communications might use its jurisdiction to preempt state regulation over local and intrastate communications service — the same way the Interstate Commerce Commission had used its powers to preempt state regulation of intrastate rail transportation. In the *Shreveport* case, *Houston East & West Texas Ry. v. United States*, 234 U.S. 342 (1914), the ICC's jurisdiction under the Interstate

Commerce Act to preempt state jurisdiction over intrastate railroad rates which were found to discriminate against interstate commerce had been upheld. In other cases, the ICC had assumed jurisdiction over intrastate transportation facilities, *e.g.*, *Railroad Commission of Ohio v. Hocking Valley Ry.*, 12 I.C.C. 398, 404 (1907); *Train Service on Northern Pacific*, 112 I.C.C. 191, 195 (1926).

Accordingly, because of the possibility that the FCC might attempt to expand its jurisdiction to include local and intrastate charges, services, facilities (as the ICC had done), representatives of the states strenuously opposed the original version of the bill as introduced in both the House and Senate. *Hearings on S. 6 Before the Senate Committee on Interstate Commerce*, 71st Cong., 1st Sess., 2167-68 (1930). Because of this opposition, the bills were amended by adding Section 2(b), which provided that nothing in the Act was to be construed to give the FCC jurisdiction over local and intrastate "charges, classifications, practices, services, facilities, or regulations."

With the addition of Section 2(b), the state commissions changed their position and supported the bill. John Benton, general solicitor of the National Association of Railroad and Utilities Commissioners, testified in favor of the amended bill as follows:

> "*Nobody suggests that the Federal Government ought to attempt to displace the State regulatory agencies in the regulation of intrastate telephone business*, yet there is danger that State regulation will be seriously hampered and broken down if care be not taken in the framing of any law providing

> for an active Federal commission, exercising jurisdiction in the communications field.
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> • • •
>
> "It is common knowledge that under the Interstate Commerce Act the power of the Interstate Commerce Commission has been so extended that State regulation of intrastate railroad rates has become little more than nominal.
>
> • • •
>
> "Unless the Congress wishes to bring control of *local telephone business, which is now subject to State regulation* under the domination of the new commission, it cannot merely transfer the existing power of the Interstate Commerce Commission to this new commission. It must describe the field within which the new commission shall operate.
>
> • • •
>
> "*This bill has been drawn with care to safeguard State power to regulate local telephone service.* It has been carefully considered by our executive and legislative committee representatives and has met their approval." Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 135-36 (1934). (Emphasis supplied.)

When this representative of the state commissions testified in support of the bill because it "has been drawn with care to safeguard State power to regulate local telephone service," he was talking about what became Sections 2(b) and 221(b), which had no parallel in the Interstate Commerce Act.

As Senator Dill, Chairman of the Senate Committee which favorable reported the bill, explained:

> ". . . [*A*]*t the request of the State Commission representatives, we wrote in certain provisions* which are not in the Interstate Commerce Act, *to protect the State commissions* against being overridden by this Commission [the FCC], as the Interstate Commerce Commission has overridden some of the railroad State commissions." Hearings on S. 2910 before the Senate Committee on Interstate Commerce, 73d Cong., 2d Sess. 179 (1934) (emphasis supplied.)

The reports of both the Senate and House Committees explained that Sections 2(b) and 221(b) were intended to reserve to the states "exclusive jurisdiction" over local and intrastate communications. Senate Reports No. 781, 73d Cong., 2d Sess., p.3; House Report No. 1850, 73d Cong., 2d Sess., pp. 4, 7.[20]

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20. In explaining the bill to the Senate, Senator Dill stated:

> *"We have attempted in title I to reserve to the State commissions the control of intrastate telephone traffic.* We have kept in mind the fact that the Interstate Commerce Commission, through the *Shreveport decision and the decisions in other similar cases,* has gone so far in the regulation of railroads that the so-called 'State regulation' amounts to very little.
>
> *"We have attempted,* in this proposed legislation, *to safeguard State regulation* by certain provisions to the effect that where existing intrastate telephone *business* is being regulated by a State commission, the provisions of the bill shall not apply." (78 Cong. Rec. 8823 (1934)).

The only reason why Congress could conceivably have included the words "services" and "facilities" to the list of matters over which the FCC had no jurisdiction was because it intended to protect the jurisdiction of the state commissions over local and intrastate services and facilities fully as much as over local and intrastate rates.

Given this background of Sections 2(b) and 221(b) and the fact that these sections were added to the Act for the express purpose of safeguarding the jurisdiction of the state commissions over local and intrastate services and facilities, as well as charges,[21] a cruel hoax would now be perpetrated on the states if the Act were

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21. The court below recognized that the states had opposed the original version of the bill, citing the *Shreveport* case as an example of unwanted expansion of federal regulatory authority; but because *Shreveport* was a rate case, the court regarded the legislative history as demonstrating only that the states wanted to protect their jurisdiction over intrastate charges — not facilities used in intrastate service. (Pet. App. [13a, n. 6]) However, apart from the fact that Section 2(b) refers to "facilities" in the same phrase as "charges," the history of the 1934 Act shows that the states' concern was not limited to rates. Benton's testimony shows a concern to protect state jurisdiction over the intrastate telephone *"business,"* and over local telephone *"service."* (*Supra,* p. 36) Senator Dill likewise described the bill as reserving to the states "control of intrastate telephone *traffic,"* and as "safeguarding state regulation" over "intrastate telephone *business."* (*Supra,* p. 38) The National Association of Railroad and Utilities Commissioners' resolution opposed the bill as originally proposed because it would interfere with the powers of the states "to regulate local *service* of utilities which operate across State lines, including the rates for such service. . . ." *Hearings on S. 2910 Before the Senate Committee on Interstate Commerce,* 73rd Cong., 2nd Sess., p. 180 (1934).

to be construed as authorizing the FCC to preempt the state commissions with respect to terminal equipment interconnected to the local switched network and used predominantly for local and intrastate service.

III.

The Court Below Erred in Construing Section 2(b) So As To Fragment Jurisdiction and Regulatory Responsibility Over Intrastate "Charges, Classifications, Practices, Services, Facilities [and] Regulations."

A further reason why this Court should review the decision below is that the decision would permit the FCC to impair if not totally destroy the power of the state commissions to pursue their ratemaking policies so far as terminal equipment is concerned. Congress recognized that regulatory authority over "charges, classifications, practices, services, and facilities" used in connection with the predominant type of service (i.e. intrastate service) should not be fragmented between different levels of government. For this reason, it grouped these matters together in providing that nothing in the Act would give the FCC any such jurisdiction.

The court below erred in construing Section 2(b) so as effectively to read the word "facilities" out of Section 2(b). But equally if not more important, the court erred in assuming that jurisdiction over "charges" and "facilities" could practically be fragmented — with the FCC regulating facilities and entry into the terminal equipment market, and the state commissions regulating charges for local and intrastate service. The

court recognized that Section 2(b) was intended to protect the jurisdiction of the state commissions over "charges." (Pet. App. [13a,n.6]; see *supra*, p. 27) But the court failed to realize what Congress had understood — that jurisdiction over local charges and facilities cannot practically be fragmented, and that the state commissions must have jurisdiction over facilities and entry into the market for terminal equipment in order to effectuate state policies with respect to charges.

Prior to the advent of state regulation, local telephone companies engaged in unrestricted competition, which often resulted in two or three competing local exchanges. Such duplicative facilities required far more investment than was necessary to create an efficient telephone network. Also, the unregulated companies were free to serve whichever locations and customers they chose to serve, and free also not to serve the less profitable segments of the market. (*Supra*, pp. 8-9)

State regulation was instituted to avoid such wasteful duplication and assure service to the entire community. It was based on the principle that telephone companies are common carrier public utilities with an obligation to serve all segments of the public. State regulatory commissions were given the power and responsibility to regulate the prices of the various classes of telephone service, and also to limit entry into the telecommunications business in order to prevent unregulated competitors, who were not required to serve all segments of the public, from "skimming the cream" of the business. The state commissions generally exercised their powers to promote universal tele-

phone service to all residential customers and to implement pricing policies based on the value of service, rather than its cost — policies which have resulted in higher rates (in relation to costs) for urban and business subscribers than for residential subscribers and those in more sparsely-populated rural areas. (*Supra*, p. 13)

The FCC's order here appealed from would foreclose the states from pursuing their ratemaking policies so far as terminal equipment is concerned, and would create pressures leading inexorably to higher residential telephone rates. By preempting the states from exercising their regulatory jurisdiction, the FCC would disable them from limiting entry into the market for terminal equipment and service and would thus make it impossible for them to prevent "cream skimming" by the unregulated manufacturers. Thus, wholly apart from its erroneous premise that Congress intended the FCC rather than the states to regulate "facilities" interconnected to the local switched network, the court below erred in believing that any such fragmentation of jurisdiction rates and facilities is a practical possibility.

This Court has itself noted that unregulated competition undercuts state regulation, and particularly state rate-making policies; and it has expressly recognized the vital importance of construing federal statutes with "meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way." *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 517-518. (1947). In *Panhandle* this Court construed the Natural Gas Act so as to sustain state regulation over direct inter-

state sales of natural gas, as follows (332 U.S. at 520-521):

> "The Natural Gas Act created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies. *It does not contemplate ineffective regulation at either level.* We have emphasized repeatedly that *Congress meant to create a comprehensive and effective regulatory scheme, complementary in its operation to those of the states and in no manner usurping their authority. Public Utilities Comm'n v. Gas Co.*, 317 U.S. 456, 467; *Power Comm'n v. Hope Gas Co.*, 320 U.S. 591 609-610; *Interstate Gas Co. v. Power Comm'n*, 331 U.S. 682, 690 . . . . The scheme was one of co-operative action between federal and state agencies. It could accomplish neither that protective aim nor the comprehensive and effective dual regulation Congress had in mind, if those companies could divert at will all or the cream of their business to unregulated industrial uses.*

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* Over 38 percent of the gross revenues of the local Indiana utilities from the sale of gas is derived from service to the approximately 250 industrial consumers served by them. If service to any substantial number of the industrial users were to be taken over by appellant, the local utilities not only would suffer great losses in revenue, but would be unable to dispense with more than a trivial percentage of their plant properties. The resultant increase in unit cost of gas would lead necessarily to increased rates for the consumers served by the local companies." (Emphasis supplied.)

See also *Panhandle Eastern Pipeline Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951). Elsewhere this Court has affirmed that, "As a matter of

statutory construction, Congressional intention to displace local laws . . . is not, in general, to be inferred unless clearly indicated. . . ." *Maurer v. Hamilton*, 309 U.S. 598, 614 (1940); and that, on the contrary, Congress has generally followed a policy of preserving state authority over "matters heretofore traditionally left to local custom or local law." *FTC v. Bunte Brothers, Inc.*, 312 U.S. 349, 354 (1941).

Here, of course, resort to general principles of construction applicable to federal regulatory statutes should have been unnecessary, since Congress expressly protected state jurisdiction in Sections 2(b) and 221(b). This Court should thus grant certiorari in this case to make it clear that the Communications Act of 1934 was not intended to fragment regulatory authority over local and intrastate telephone "charges, classifications, practices, services, facilities, regulations," or to render and part of the authority of the state commissions "ineffective."

IV.

This Court Should Grant Certiorari to Vindicate Basic Principles of Federalism

At bottom, this case does *not* present any question as to whether competition rather than regulation with respect to terminal equipment is in the public interest. Rather, it presents the issue of which level of government — federal or state — is authorized, under the Communications Act of 1934, to decide what is in the interest of the public, which uses telecommunications service.

The decision of the court below appears to have

turned less on statutory language than on an unarticulated premise that any entity as large and complicated as our national telephone network somehow must be regulated in its entirety by a federal agency, rather than a multitude of state commissions. No premise could be further from the truth. Our national telephone network is, in fact, made up of hundreds of local telephone companies and exchanges, all with different markets, customer needs, and service problems. In 1934 these facilities were used approximately 98% of the time for local or intrastate calls; today approximately 97% of all calls are local or intrastate. In recognition of this fact, Congress attempted in Sections 2(b) and 221(b) to preserve state regulatory jurisdiction over this predominantly local variety of service. As already pointed out (*Supra*, p. 33), the FCC itself recently recognized that Congress in enacting the 1934 Act had properly decided that "the tail should not wag the dog" (*General Telephone Co.*, 14 F.C.C. 2d 695, 696 (1968).

We have in this country telephone communications systems of unsurpassed excellence and efficiency, and we have built and maintained these systems — since the very beginnings of the industry, and certainly in the four decades since 1934 — almost exclusively under state regulation. This record of state regulation of predominantly local and intrastate telecommunications service certainly compares favorably, to say the least, with the results of federal agency regulation of such predominantly interstate carrier services as railroad transportation and the airline industry.

The right of the states in our federal system to adopt policies reflecting local conditions and local views as to what promotes the public interest, and to

experiment in implementing these policies, should be preserved. Our system of government is founded on the belief that progress will most likely be achieved, and stagnation avoided, not by a single, monolithic government or governmental rule, but by a multitude of governments — with the states and local governments free to adopt policies reflecting local conditions and local views as to what promotes the public interest. This belief has nowhere been better expressed than by Mr. Justice Brandeis, dissenting in *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932):

> "There must be power in the States and the Nation to remould, through experimentation, our economic practices and institutions to meet changing social and economic needs. I cannot believe that the framers of the Fourteenth Amendment, or the States which ratified it, intended to deprive us of the power to correct the evils of technological unemployment and excess productive capacity which have attended progress in the useful arts. [Footnote omitted]
>
> "To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

This Court has vindicated[22] the views of Justice Brandeis and has emphasized the importance, in construing federal regulatory statutes, of protecting the regulatory powers of the state commissions. Thus, in *Connecticut Light & Power Co. v. F.P.C.*, 324 U.S. 515 (1945), this Court held that in enacting the Federal Power Act, Congress had preserved the power of the states to devise their own regulatory policies for dealing with local public utilities. In doing so, this Court emphasized the importance of state regulation as providing "laboratories" for testing regulatory policies (324 U.S. at 530):

> "But state lines and boundaries cut across and subdivide what scientifically or economically viewed may be a single enterprise. Congress is acutely aware of the existence and vitality of these state governments. It sometimes is moved to respect state rights and local institutions even when some degree of efficiency of a federal plan is thereby sacrificed."
>
> * * *
>
> "Congress may think complete centralization of control of the electric industry likely to overtax administrative capacity of a federal commission. It may, too, think it wise to kep the hand of state regulatory bodies in this business, *for the 'insulated chambers of the states' are still laboratories where*

22. Although the *New State Ice* case has never expressly been overruled, the Supreme Court has recognized that Mr. Justice Brandeis' dissent, rather than the majority opinion, states the correct interpretation of the Due Process Clause and accurately describes the power of the States to regulate public utilities. See *Nebbia* v. *New York*, 291 U.S. 502 (1934); *Breard* v. *Alexandria*, 341 U.S. 622, 630-33 (1951); *Fay* v. *New York*, 332 U.S. 261, 296 (1947). See also *Johnson* v. *Louisiana*, 406 U.S. 356, 376 n.16 (1972) (concurring opinion of Mr. Justice Powell).

many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment." (Emphasis supplied.)

Unless the decision below is reviewed by this Court and reversed, the state regulatory commissions will be handcuffed, and a single regulatory rule — or non-rule — will have been imposed by the FCC, without regard to possible variations in the state of technological development or economic vitality of local or state telephone companies, and without regard to the desirability of permitting each state to experiment in maintaining its own public policy.

Conclusion

For these reasons, the petition for certiorari should be granted.

Respectfully submitted,

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